

Looking for something to read? See our [Reading List](#); these books, separated by category, are ones we find interesting and insightful. We will be adding to the list over time.

**[Posted: May 31, 2024—9:30 AM EDT]** Global equity markets are mixed this morning. In Europe, the Euro Stoxx 50 is up 0.1% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed down 1.3%. Chinese markets were mixed, with the Shanghai Composite down 0.2% from its previous close and the Shenzhen Composite up 0.2%. US equity index futures are signaling a higher open.

The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [Bi-Weekly Geopolitical Report](#) (5/20/2024) (there is no associated podcast): “The Great COVID Labor Reform”
- [Asset Allocation Quarterly – Q2 2024](#) (4/25/2024): Discussion of our asset allocation process, Q2 2024 portfolio changes, and our outlook for the markets.
- [Asset Allocation Q2 2024 Rebalance Presentation](#) (5/7/2024): Video presentation featuring the Asset Allocation Committee as they review the asset allocation strategies, recent portfolio changes, and the current macro environment.
- [Asset Allocation Bi-Weekly](#) (5/28/2024) (with associated [podcast](#)): “The Importance of the Federal Reserve’s Inflation Target”
- [Confluence of Ideas podcast](#) (5/8/2024) “Reviewing the Asset Allocation Rebalance: Q2 2024”
- **[Business Cycle Report](#) (5/30/24)**

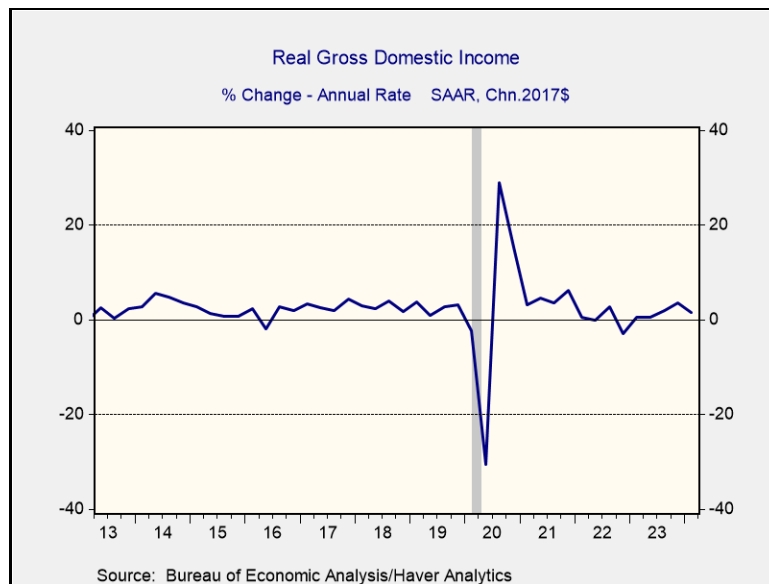
Good morning! Equity futures are trading higher after the PCE price index showed that inflation continues to stay in line with expectations. In sports news, the Dallas Mavericks defeated the Minnesota Timberwolves, setting up a final’s matchup with the Boston Celtics. Today’s *Comment* dives deep into Thursday’s GDP report and explores reasons for our continued economic optimism. We’ll also analyze the West’s further crackdown on chip exports and offer a primer on the upcoming elections in Mexico this weekend. As usual, our report concludes with a round-up of domestic and international data releases.

**GDP Breakdown:** While GDP revisions confirmed a first-quarter slowdown, uncertainty lingers about whether it’s a temporary dip or a sign of more significant trouble.

- [US economic growth in the first quarter was weaker than initially estimated](#). GDP was revised downward to an annualized rate of 1.3%, down from 1.6%. Both consumer

spending and inflation were lower than previously reported, with consumer spending growth revised down to 2.0% from 2.5% and the PCE price index for the quarter coming in at 3.6%, down from the initial estimate of 3.7%. While underlying fundamentals suggest the economy isn't in immediate danger of recession, there are signs of waning economic momentum.

- Gross Domestic Income (GDI), released only after the second GDP estimate, confirmed potential weakness in economic output. The report showed that growth slowed from an annualized growth rate of 3.6% in Q4 2024 to 1.5% the following quarter. While both reports should theoretically reflect similar trends, they can actually tell different stories. The GDP report, which is focused on production activity, reveals a drag from declining inventories and rising imports. In contrast, GDI, which measures income earned by residents, suggests corporate profits also took a hit, contracting 1.7% in the first three months of the year, down from the previous quarter's rise of 3.9%.



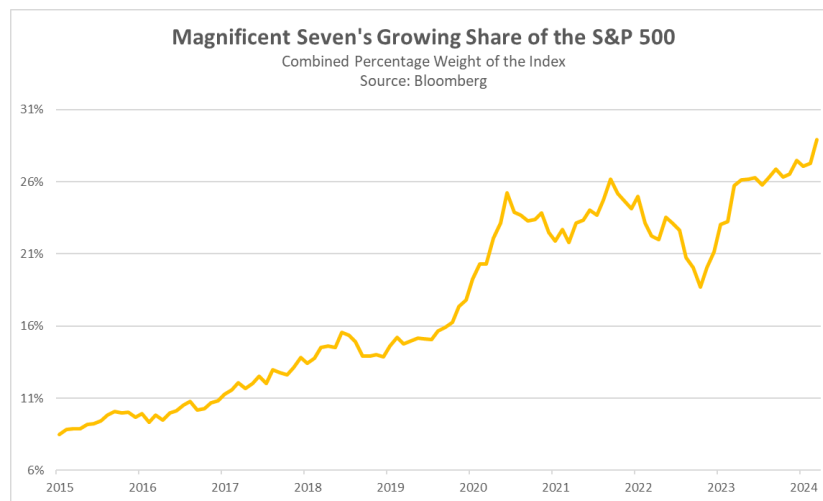
- While recent data suggests slowing growth, it's important to consider the historical context. The past four recessions were all triggered by unforeseen events: the 2020 pandemic, the 2008 Lehman Brothers collapse, the 9/11 attacks in 2001, and the Gulf War in 1990. Hence, a slowdown doesn't necessarily foreshadow an immediate downturn. While the economy faces challenges, we remain cautiously optimistic that it can weather these headwinds, absent any major disruptions such as a mass mobilization war, commodity supply shock, or pandemic. That said, a period of subpar growth is still a possibility for 2024.

**More Export Controls on Chips:** The West's crackdown on semiconductor sales to its adversaries has been extended to the Middle East, reflecting concerns about potential leaks.

- [US regulators are scrutinizing the national security implications](#) of artificial intelligence (AI) development. As a precaution, they've tightened export controls on AI accelerator chips specifically for certain Middle Eastern countries. These chips are in high demand

because they excel at processing large datasets while consuming less energy. The technology has become crucial for companies and governments looking to build out their AI infrastructure. Companies like Nvidia, AMD, and Intel Corp have been waiting on the sideline for approval to sell these chips to countries such as Saudi Arabia, Qatar, and the United Arab Emirates.

- This national security scrutiny comes amid a surge in AI stocks. For instance, [Nvidia, the third-largest chipmaker by revenue](#), has fueled more than 30% of the S&P 500's total returns this year, highlighting the booming AI market. Bloomberg analysis suggests that this is the largest share of a market leader at this point of the year in at least a decade. This dominance highlights the tech sector's increasing concentration within the index. While concentration isn't new, the current level is unprecedented. The ["Magnificent Seven" tech companies now account for over 30% of the S&P 500](#), a significant jump from 20% in 2020.



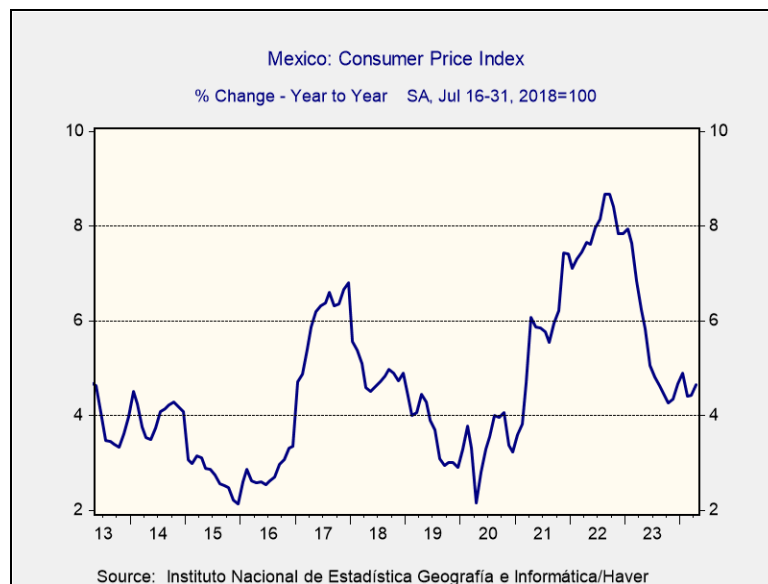
- The tech industry faces heightened scrutiny due to growing geopolitical tensions, which is why we closely monitor the landscape. As countries form blocs, trade restrictions could disproportionately impact the revenue of large tech companies heavily reliant on foreign markets, particularly those with significant exposure to China. While these companies aren't facing immediate risks, the future holds uncertainty due to geopolitical tensions. To mitigate portfolio risk, investors might consider small and mid-cap companies, which generally have attractive valuations relative to their large cap counterparts but also tend to have a more domestic focus that can make them less vulnerable to shifting trade patterns.

**Mexican Elections:** Elections in Mexico are set to take place over the weekend as the country looks to replace its controversial but fiscally prudent leader.

- Current polls indicate that Claudia Sheinbaum, the chosen successor of President Andrés Manuel López Obrador (AMLO), is heavily favored to win the election. Sheinbaum is leading her opponents, Xóchitl Gálvez and Jorge Álvarez Máynez, by a wide margin. The [latest data suggests that she is poised to secure more than half of the vote](#), with Gálvez projected to receive around a third and Máynez anticipated to garner the remainder.

Despite her lead, there have been talks that [high voter turnout for the opposition may lead to an upset](#), as her popularity has shown signs of waning during the run-up to the election.

- Sheinbaum is expected to carry on the legacy of her predecessor, AMLO. Under his administration, the country's inflation rate has stabilized, returning to its long-term average in a relatively short time. Additionally, the [government exhibited fiscal prudence during the pandemic's onset](#), incurring smaller deficits than most Latin American nations. This fiscal responsibility, coupled with an increase in foreign investment, has benefited the [Mexican peso \(MXN\), which has largely outperformed its peer currencies](#). However, the next administration will face challenges, including rising gang violence, a sluggish economy, and concerns about border security.

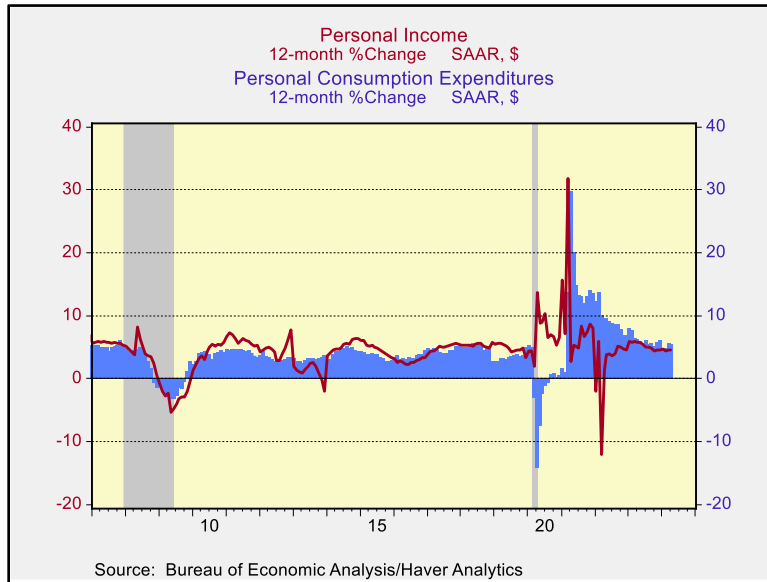


- The success of the next administration will likely hinge on how the next president handles relations with their northern counterpart. Despite border security disputes, AMLO maintained relatively good relationships with both former President Donald Trump and current President Joe Biden. However, concerns are growing that Mexico has become too close to the United States' rival, China. [Several Chinese automakers are exploring the possibility of building factories in Mexico](#). These facilities would strategically position them to sell electric vehicles in the US market, bypassing hefty tariffs. Should this come to fruition, the US might seek to update or renegotiate the USMCA trade agreement.

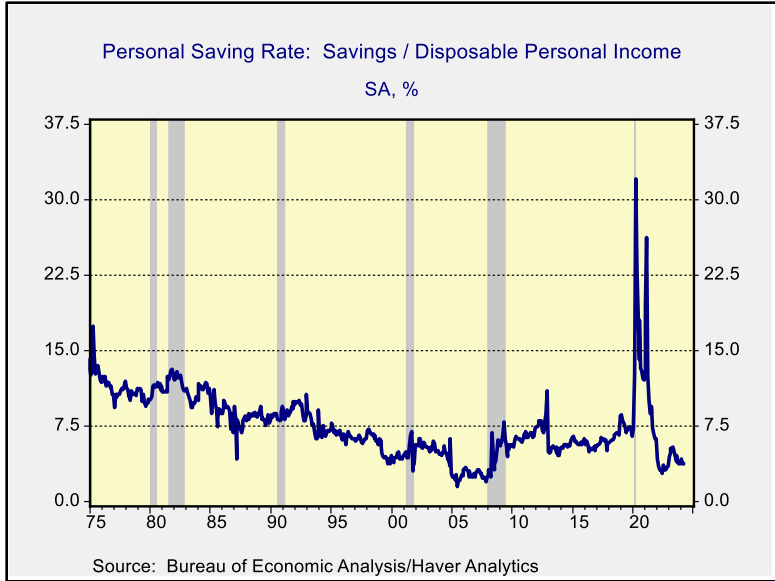
**In Other News:** Former [President Trump was found guilty in the hush money trial](#). Although his conviction does not impact his eligibility to run for office, it may damage his perception among voters. Meanwhile, President Biden has permitted Ukraine to [use US-made weapons to strike military targets in Russia](#); this marks a significant escalation in tension and could pave the way for a broader war.

## US Economic Releases

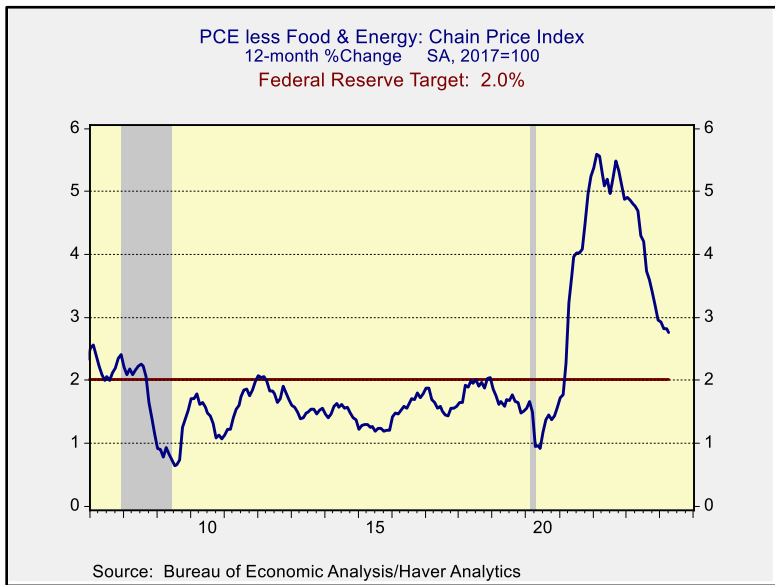
April *personal income* rose by a seasonally adjusted 0.3%, matching expectations but still a bit weaker than the March gain of 0.5%. Meanwhile, April *personal consumption expenditures (PCE)* rose 0.2%, short of the anticipated increase of 0.3% and much weaker than the revised March increase of 0.7%. Personal income in April was up 4.5% from the same month one year earlier, while PCE was up 5.3%. The chart below shows the year-over-year change in personal income and PCE since just before the Great Financial Crisis.



The personal income and spending report also includes a measure of personal saving, defined as disposable (after tax) income less consumption spending on goods and services. The April *personal savings rate* held steady at a low seasonally adjusted 3.6%. The chart below shows how the personal savings rate has fluctuated since just before the GFC.



Finally, the income and spending report includes the Federal Reserve’s preferred measure of consumer price inflation. After stripping out the volatile food and energy components, the April **Core PCE Deflator** was up 2.8% from the same month one year earlier. That was exactly as expected, and it matched the increase in the year to March. The chart below shows the year-over-year change in the Core PCE Deflator since just before the GFC.



The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
EST	Indicator			Expected	Prior	Rating
9:45	MNI Chicago PMI	m/m	May	41.1	37.9	***
Federal Reserve						
EST	Speaker or Event	District or Position				
18:15	Raphael Bostic Gives Commencement Speech	President of the Federal Reserve Bank of Atlanta				

## Foreign Economic News

We monitor numerous global economic indicators on a continuous basis. The most significant international news that was released overnight is outlined below. Not all releases are equally significant, thus we have created a star rating to convey to our readers the importance of the various indicators. The rating column below is a three-star scale of importance, with one star being the least important and three stars being the most important. We note that these ratings do change over time as economic circumstances change. Additionally, for ease of reading, we have also color-coded the market impact section, which indicates the effect on the foreign market. Red indicates a concerning development, yellow indicates an emerging trend that we are following closely for possible complications, and green indicates neutral conditions. We will add a paragraph below if any development merits further explanation.

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
<b>ASIA-PACIFIC</b>								
<b>Japan</b>	Jobless Rate	m/m	Apr	2.6%	2.6%	2.6%	***	Equity and bond neutral
	Job-To-Applicant Ratio	m/m	Apr	126.0%	128.0%	128.0%	***	Equity and bond neutral
	Tokyo CPI	y/y	May	2.2%	1.8%	2.2%	**	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food	y/y	May	1.9%	1.6%	1.9%	***	Equity and bond neutral
	Tokyo CPI Ex-Fresh Food & Energy	y/y	May	1.7%	1.8%	1.8%	*	Equity and bond neutral
	Depart. Store & Supermarket Sales	y/y	Apr	2.7%	6.5%		*	Equity and bond neutral
	Industrial Production	y/y	Apr P	-1.0%	-6.2%	-1.1%	***	Equity and bond neutral
	Retail Sales	y/y	Apr	2.4%	1.1%	1.7%	**	Equity bullish, bond bearish
	Housing Starts	y/y	Apr	13.9%	-12.8%	-0.1%	**	Equity bullish, bond bearish
	Annualized Housing Starts	y/y	Apr	0.880m	0.760m	0.777m	*	Equity and bond neutral
<b>Australia</b>	Private Sector Credit	y/y	Apr	5.2%	5.2%		**	Equity and bond neutral
<b>South Korea</b>	Industrial Production	y/y	Apr	6.1%	1.0%	4.4%	***	Equity bullish, bond bearish
<b>China</b>	Official Manufacturing PMI	m/m	May	49.5	50.4	50.5	***	Equity and bond neutral
	Official Services PMI	m/m	May	51.1	51.2	51.5	**	Equity and bond neutral
	Official Composite PMI	m/m	May	51.0	51.7		*	Equity and bond neutral
<b>India</b>	GDP	q/q	1Q	7.8%	8.6%	7.0%	**	Equity bullish, bond bearish
<b>EUROPE</b>								
<b>Eurozone</b>	CPI	y/y	May P	2.6%	2.4%	2.5%	***	Equity and bond neutral
	Core CPI	y/y	May P	2.9%	2.7%	2.7%	**	Equity and bond neutral
<b>Germany</b>	Import Price Index	y/y	Apr	-1.7%	-3.6%	-1.8%	*	Equity and bond neutral
	Retail Sales	y/y	Apr	1.8%	-1.9%	2.5%	*	Equity bearish, bond bullish
<b>France</b>	CPI	y/y	May P	2.2%	2.2%	2.4%	***	Equity and bond neutral
	CPI, EU Harmonized	y/y	May P	2.7%	2.4%	2.6%	**	Equity and bond neutral
	PPI	y/y	Apr	-6.8%	-8.3%		*	Equity and bond neutral
	GDP	y/y	1QF	1.3%	1.1%	1.1%	**	Equity and bond neutral
<b>Italy</b>	CPI, EU Harmonized	y/y	May P	0.8%	0.9%	0.7%	***	Equity and bond neutral
	CPI NIC Including Tobacco	y/y	May P	0.8%	0.8%	0.7%	**	Equity and bond neutral
	PPI	y/y	Apr	-8.1%	-12.7%		**	Equity and bond neutral
	GDP WDA	y/y	Q1 F	0.7%	0.6%	0.6%	**	Equity and bond neutral
<b>UK</b>	Nationwide House Price Index	y/y	May	1.3%	0.6%	0.9%	***	Equity and bond neutral
	Net Lending Sec. on Dwellings	m/m	Apr	2.4b	0.5b	0.4b	*	Equity bullish, bond bearish
	Mortgage Approvals	m/m	Apr	61.1k	61.3k	61.5k	***	Equity and bond neutral
	M4 Money Supply	y/y	Apr	0.6%	0.5%	0.4%	*	Equity and bond neutral
<b>Switzerland</b>	Real Retail Sales	y/y	Apr	2.7%	-0.2%		**	Equity and bond neutral
<b>Russia</b>	Gold and Forex Reserves	m/m	24-May	\$605.9b	\$603.7b		***	Equity and bond neutral
	Money Supply, Narrow Definition	w/w	24-May	18.20t%	18.31t%		*	Equity and bond neutral
<b>AMERICAS</b>								
<b>Canada</b>	Current Account Balance	m/m	1Q	-5.37b	-\$1.62b	-\$4.51b	**	Equity and bond neutral

## Financial Markets

The table below highlights some of the indicators that we follow daily. Again, the color coding is similar to the foreign news description above. We will add a paragraph below if a certain move merits further explanation.

Fixed Income	Today	Prior	Change	Trend
3-mo Libor yield (bps)	561	561	0	Up
3-mo T-bill yield (bps)	525	525	0	Up
U.S. Sibor/OIS spread (bps)	534	534	0	Up
U.S. Libor/OIS spread (bps)	535	535	0	Up
10-yr T-note (%)	4.55	4.55	0.00	Up
Euribor/OIS spread (bps)	379	379	0	Down
Currencies	Direction			
Dollar	Flat			Up
Euro	Up			Up
Yen	Down			Down
Pound	Down			Up
Franc	Down			Down

## Commodity Markets

The commodity section below shows some of the commodity prices and their change from the prior trading day, with commentary on the cause of the change highlighted in the last column.

DOE Inventory Report	Price	Prior	Change	Explanation
<b>Energy Markets</b>				
Brent	\$81.83	\$81.86	-0.04%	
WTI	\$77.96	\$77.91	0.06%	
Natural Gas	\$2.55	\$2.57	-0.74%	
12-mo strip crack	\$21.26	\$20.96	1.43%	
Ethanol rack	\$1.97	\$1.97	-0.08%	
<b>Metals</b>				
Gold	\$2,344.21	\$2,343.07	0.05%	
Silver	\$31.31	\$31.17	0.43%	
Copper contract	\$464.15	\$465.85	-0.36%	
<b>Grains</b>				
Corn contract	\$452.75	\$448.75	0.89%	
Wheat contract	\$688.50	\$681.00	1.10%	
Soybeans contract	\$1,222.00	\$1,209.75	1.01%	
<b>Shipping</b>				
Baltic Dry Freight	1,801	1,790	11	
<b>DOE Inventory Report</b>				
	Actual	Expected	Difference	
Crude (mb)	4.16	-1.15	5.31	
Gasoline (mb)	2.02	-1.50	3.52	
Distillates (mb)	2.54	0.00	2.54	
Refinery run rates (%)	2.6%	0.4%	2.3%	
Natural gas (bcf)	84	78	6	

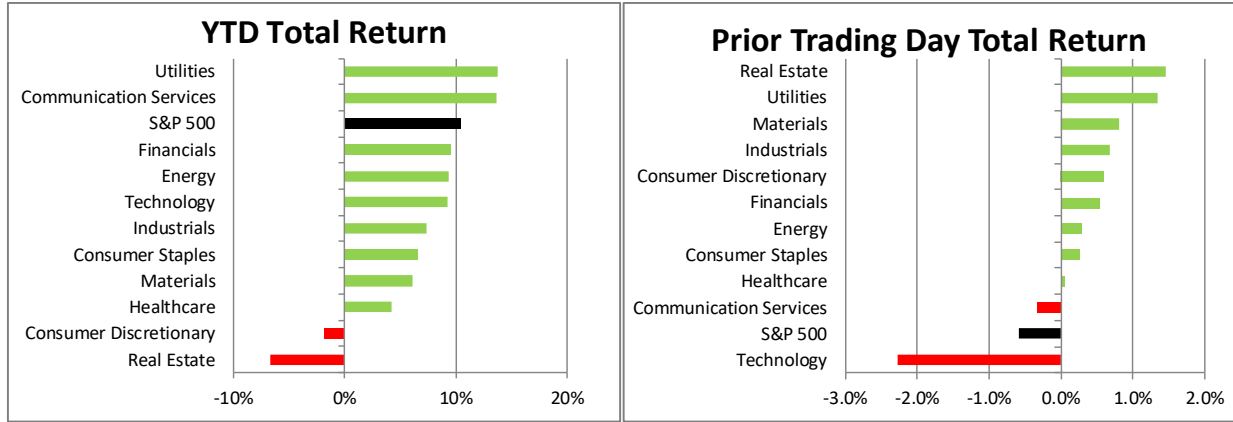


## **Weather**

The 6-10 and 8-14 day forecasts call for warmer-than-normal temperatures in the Far West and the Deep South, with cooler-than-normal temperatures in the Midwest. The forecasts call for wetter-than-average conditions in the southern Great Plains and the Northeast, with dry conditions along the Northern Tier states.

**Data Section**

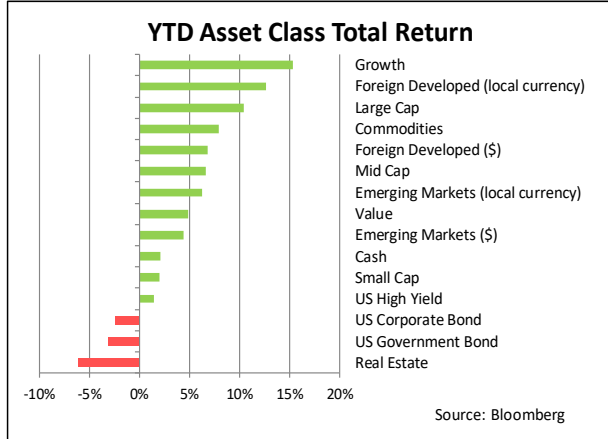
**US Equity Markets – (as of 5/30/2024 close)**



(Source: Bloomberg)

These S&P 500 and sector return charts are designed to provide the reader with an easy overview of the year-to-date and prior trading day total return. Sectors are ranked by total return; green indicating positive and red indicating negative return, along with the overall S&P 500 in black. These charts represent the new sectors following the 2018 sector reconfiguration.

**Asset Class Performance – (as of 5/30/2024 close)**

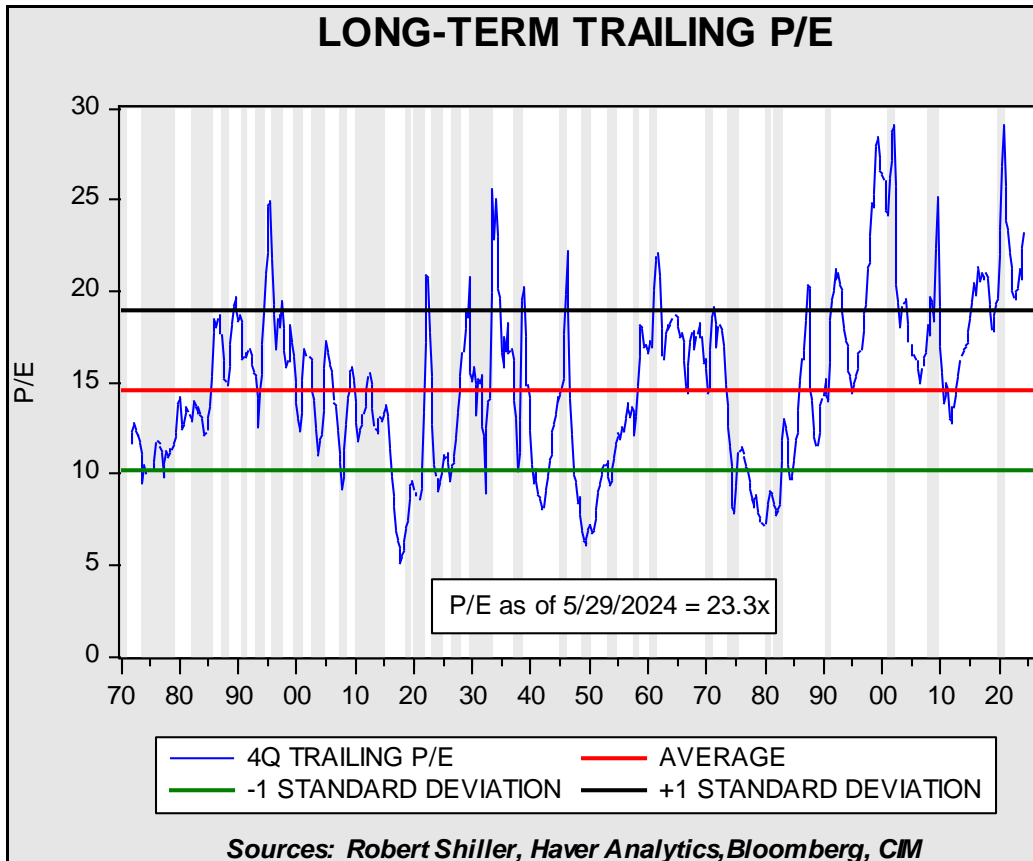


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

Asset classes are defined as follows: Large Cap (S&P 500 Index), Mid Cap (S&P 400 Index), Small Cap (Russell 2000 Index), Foreign Developed (MSCI EAFE (USD and local currency) Index), Real Estate (FTSE NAREIT Index), Emerging Markets (MSCI Emerging Markets (USD and local currency) Index), Cash (iShares Short Treasury Bond ETF), US Corporate Bond (iShares iBoxx \$ Investment Grade Corporate Bond ETF), US Government Bond (iShares 7-10 Year Treasury Bond ETF), US High Yield (iShares iBoxx \$ High Yield Corporate Bond ETF), Commodities (Bloomberg total return Commodity Index), Value (S&P 500 Value), Growth (S&P 500 Growth).

## P/E Update

May 30, 2024



Based on our methodology,<sup>1</sup> the current P/E is 23.3x, up 0.1 from our last report. The increase in the multiple was due to an increase in the stock price index, outpacing the increase in earnings.

*This report was prepared by Confluence Investment Management LLC and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This is not a solicitation or an offer to buy or sell any security.*

<sup>1</sup> This chart offers a running snapshot of the S&P 500 P/E in a long-term historical context. We are using a specific measurement process, similar to *Value Line*, which combines earnings estimates and actual data. We use an adjusted operating earnings number going back to 1870 (we adjust as-reported earnings to operating earnings through a regression process until 1988), and actual operating earnings after 1988. For the current quarter, we use the Bloomberg estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes three actual quarters (Q2, Q3 and Q4) and one estimate (Q1). We take the S&P average for the quarter and divide by the rolling four-quarter sum of earnings to calculate the P/E. This methodology isn't perfect (it will tend to inflate the P/E on a trailing basis and deflate it on a forward basis), but it will also smooth the data and avoid P/E volatility caused by unusual market activity (through the average price process). Why this process? Given the constraints of the long-term data series, this is the best way to create a long-term dataset for P/E ratios.